

**SUMMARY OF THE REGULAR MEETING OF THE  
ARIZONA STATE RETIREMENT SYSTEM  
INVESTMENT COMMITTEE**

**HELD ON  
Wednesday, October 4, 2006  
5:30 p.m., MST**

The Investment Committee (IC) of the Arizona State Retirement System (ASRS) met at 3300 N. Central Avenue, 14th Floor Conference Room, Phoenix, Arizona 85012. Mr. Lawrence Trachtenberg, Chairperson of the IC, called the meeting to order at 5:44 p.m., MST.

The meeting was teleconferenced to the ASRS Tucson office, 7660 East Broadway Boulevard, Suite 108, Tucson, Arizona 85710.

**1. Call to Order; Roll Call; Opening Remarks**

Present: Mr. Lawrence Trachtenberg, Chairperson  
Mr. Karl Polen  
Mr. Christopher Harris

Absent: Ms. Anne Mariucci

Also present: Dr. Keith Meredith, Chairperson, ASRS Board – via teleconference

A quorum was present for the purpose of conducting business.

**2. Presentation, Discussion, and Appropriate Action Regarding the Asset Allocation Study  
– Part 2**

Mr. Gary R. Dokes, ASRS Chief Investment Officer, introduced Part 2 of the ASRS Asset Allocation Study. Part 2 of the Study addresses implementation of the strategic asset allocation and Total Fund construction issues. This process will require analysis of and decisions regarding the total level of active risk in the portfolio, active vs. passive allocation, value vs. growth balance, allocation of active risk across various asset classes, tactical asset allocation strategies, portfolio rebalancing, and performance benchmarks.

A presentation, which was the result of a joint project between the ASRS and New England Pension Consultants (NEPC), was given to the IC by Mr. Paul Matson, Director, Mr. Dokes, Mr. Dan Kapanak, Manager of Investment Analysis, and Mr. Allan Martin, NEPC. The presentation

contained data, analysis, and proposals regarding the broad strategic asset allocation policy, approach to absolute return strategies, and portfolio construction issues.

Mr. Dokes gave an overview of the Asset Allocation paradigm and policy schematic (Exhibit A).

## ASRS Asset Allocation Policy Schematic (Exhibit A)

	Investment Category	Current Policy	Actual Alloc. 9/22/2006	Proposed Policy			
				Target	Range	Passive	Benchmark
Asset Classes	US Equity						
	Large Cap	43%	44%	31%	26 - 36%	65 ±10	S&P 500
	Mid Cap	5	6	7	5 - 9	45 ±20	S&P 400
	Small Cap	5	6	7	5 - 9	30 ±20	S&P 600
	Sub-Total	53	56	45	40 - 50		
	International Equity	15	18	18	13 - 20	10 ±5	MSCI ACWI ex. US
	US Fixed Income	26	25	26	21 - 31	55 ±20	Lehman Aggregate
	Real Estate	6	1	6	4 - 8	NA	NCREIF + 1%
	Private Equity	0	0	5	3 - 7	NA	Russell 3000 + 3%
	TOTAL	100	100	100			
Strategies within Asset Classes: Beta exposure with active risk	Opportunistic Asset Classes:	0	1.5	0	0 - 5	NA	Asset Class Specific (TBD)
	• Int'l Equity Small Cap	1.5	1.5	1.8	0 - 3.6	0	MSCI EAFE Small Cap
	Global TAA	10	10.5	10	8 - 12	NA	ASRS Total Fund Benchmark
	Expected Return	8.02%	8.22%	8.30%			
Investment Strategies	Standard Deviation	11.49%	12.03%	11.88%			
	Sharpe Ratio	0.37	0.37	0.38			
	Absolute Return Strategies	0	0	0	0 - 5	NA	> 0%
	(Assumes: Maximum 5% Allocation, Volatility 3% Relative to Cash, Return: Cash + 3%, IR of 1.0)						
	Expected Return			8.43%			
	Standard Deviation			11.96%			
	Sharpe Ratio			0.39			
	Total Fund Benchmark:	31% Large Cap (S&P 500), 7% Mid Cap (S&P 400), 7% Small Cap (S&P 600), 18% Intl Equity (ACWI xUS)					
		26% Fixed Income (Leh. Agg.), 6% Real Estate (NCREIF + 1%), 5% Private Equity (Russell 3000 + 3%)					
	Red denotes changes from ASRS existing Asset Allocation Policy which was approved by the Board in August 2003						

Prepared by the ASRS

NEPC Capital Markets Assumptions

The Asset Allocation paradigm consists of:

- Asset Class vs. Investment Strategies
- Decision-making Methodology
- Dynamic Asset Allocation Study Approach

Mr. Kapanak elaborated on some of the observations of the Study, including international equity, opportunistic asset classes, and absolute return strategies performance framework and implementation. Discussion ensued regarding the policy schematic.

Mr. Martin offered the institutional perspective of NEPC on the various asset classes and the corresponding recommended investment strategies. He explained the minor differences between the viewpoint of the ASRS and NEPC regarding broad asset allocation perspectives.

Mr. Dokes pointed out that a dynamic asset allocation approach provides more flexibility than the traditional 3-year policy asset mix review. This is because investment opportunities and asset classes are constantly evolving and developing, such that they may become attractive and suitable for institutional investment portfolios before the next scheduled policy review. Implementation of the recommendations would be targeted to occur on or before March 31, 2007. An interim Total Fund benchmark would be used.

Mr. Kapanak explained the risk budgeting management objectives and the ASRS risk budgeting initiative, which was first evaluated by the Investment Management Division (IMD) in April 2005.

Mr. Matson discussed the importance, when looking at absolute return strategies, of the underlying economics, using expertise and resources of internal IMD staff and software, as well as external consultants, to assess the risk of potential investment options.

**Motion:** Mr. Karl Polen moved that the IC recommend that the ASRS Board approve:

- The ASRS Asset Allocation Policy Schematic (Exhibit A), which contains policy targets/ranges for the ASRS broad asset classes, investment strategies, passive/active and GTAA program and benchmarks for the ASRS broad asset classes and Total Fund.

*and*

- The ASRS Dynamic Asset Allocation approach, which initiates an asset allocation study based on market dynamics rather than set 3-year periodicity, and provides for the potential introduction of new asset classes on a periodic basis. An ASRS Asset Allocation Study will be conducted as a result of the aforementioned or triennially, whichever is shorter.

Mr. Christopher Harris seconded the motion.

By a vote of 3 in favor, 0 opposed, 0 abstentions, and 1 excused the motion was approved.

#### **4. Presentation and Discussion Regarding ASRS Performance Evaluation Framework**

Mr. Dokes introduced the performance evaluation framework for the ASRS. The framework will address appropriate performance benchmarks (i.e. absolute, relative, peer comparison) for various levels (i.e. Total Fund, asset class, manager).

Mr. Kapanak elaborated on key topics addressed in developing a comprehensive performance evaluation framework. The framework will be based on a core set of principles for selecting benchmarks and will be consistent across the entire life cycle of an investment manager, from hiring through ongoing evaluation and retention to possible termination situations. The following are the core principles to be used in selecting benchmarks:

- ASRS Strategic Plan
- CFA Institute Report
- Asset Allocation/Efficient Frontier Analysis
- Consistent Across Manager Life Cycle

The IMD currently performs informal quarterly evaluations of investment managers, based on philosophy, process, personnel, and performance.

#### **5. Presentation and Discussion Regarding Future IC Agenda Topics**

None.

#### **6. Call to the Public**

No members of the public requested to speak to the IC.

The meeting adjourned at 7:15 PM.

Respectfully submitted,

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Lisa Hanneman, Secretary

Date

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Gary Dokes, Chief Investment Officer

Date